



SECOND QUARTER **2019**

PHX Energy Services Corp.

Second Quarter Report for the three and six-month periods ended June 30, 2019 and 2018

Financial Results

For the three-month period ended June 30, 2019, the Corporation realized adjusted EBITDA of \$11 million the highest second quarter adjusted EBITDA (see "Non-GAAP Measures") achieved in PHX Energy's history. This level of adjusted EBITDA is 10 percent greater than the adjusted EBITDA of \$10 million in the respective 2018-quarter. Consolidated revenue for the three-month period ended June 30, 2019 was \$83 million, a 20 percent increase over the \$69 million generated in the second quarter of 2018 and the second highest consolidated revenue achieved for a second quarter in the Corporation's history, with the second quarter of 2014 being the highest. This level of revenue was achieved mainly as a result of the continued strength in PHX Energy's US segment, despite weaker activity in the Canadian industry.

For the three-month period ended June 30, 2019, PHX Energy capitalized on its strong momentum in the US attaining the highest quarterly revenue for the US division since the fourth quarter of 2014. US revenue increased by 30 percent to \$67.1 million from \$51.6 million in the corresponding 2018-quarter. The Corporation's drilling activity in the US improved by 11 percent in the 2019-quarter, growing to 3,903 operating days in comparison to 3,523 days in the 2018-quarter. This growth is in contrast to the US industry's activity which declined 5 percent from 1,039 average rigs running per day in the second quarter of 2018 to 989 rigs in the 2019-quarter (Source: Baker Hughes). The Corporation increased activity in the US by expanding the capacity of its high performance technology fleets, specifically Velocity Real Time-Time Systems ("Velocity"), PowerDrive Orbit Rotary Steerable Systems ("RSS"), and Atlas High Performance ("Atlas") Motors.

In contrast, the Canadian industry's outlook continues to be negatively affected by uncertainty around new takeaway capacity, which has resulted in prolonged industry challenges in 2019. The Canadian market's activity fell 25 percent quarter-over-quarter with an average of 79 active rigs operating per day in the second quarter of 2019 (2018 – 105 rigs) (Source: Baker Hughes). For the three-month period ended June 30, 2019, the Canadian segment's revenue was \$10.7 million as compared to \$12.7 million in the 2018-quarter.

As at June 30, 2019, the Corporation had loans and borrowings of \$16.3 million as well as operating facility borrowings of \$6.6 million. These debt items less cash and cash equivalents of \$7.4 million resulted in net debt of \$15.5 million (December 31, 2018 - \$21.5 million). As at June 30, 2019, the Corporation's working capital was \$56.9 million.

Capital Spending

For the six-month period ended June 30, 2019, the Corporation spent \$20.4 million in capital expenditures. Capital expenditures were primarily directed towards Velocity Systems and Atlas Motors, and were \$12.6 million higher than the \$7.8 million spent in the first half of 2018. The Corporation funded capital spending in the 2019-year through net cash flows from operations and its working capital and debt facilities.

As at June 30, 2019, the Corporation had \$6.3 million of outstanding capital commitments, which is comprised of \$4.5 million for Velocity Systems and \$1.8 million for collars, performance drilling motors and other machine and equipment. Delivery of these purchases is expected to occur by the end of 2019.

On April 8, 2019, the Corporation announced an increase to its capital expenditure program from \$15 million to \$25 million. In the second quarter of 2019, PHX Energy's Board of Directors (the "Board") approved an increase to the 2019 capital expenditure program that resulted in the budget being set at \$30 million as compared to the \$25 million previously announced. In the 2019-year, the Corporation expects to spend \$21 million growing the Corporation's fleet of drilling equipment and \$9 million to maintain the current fleet of drilling and other equipment. The Corporation anticipates that capital expenditures for the 2019-year will be allocated as follows: \$15 million towards performance drilling motors primarily relating to Atlas Motors, \$12 million on MWD systems, primarily relating to Velocity, and \$3 million relating to machinery and equipment, and collars.

Normal Course Issuer Bid

During the third quarter of 2018, the Toronto Stock Exchange ("TSX") approved the renewal of PHX Energy's normal course issuer bid (the "NCIB") to purchase for cancellation, from time-to-time, up to a maximum of 2,915,311 common shares, representing 5 percent of the outstanding common shares at the time the NCIB was renewed. The NCIB commenced on August 8, 2018 and will terminate on August 7, 2019. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase. Pursuant to the NCIB, 2,595,300 common shares have been purchased and cancelled by the Corporation as at July 31, 2019, of which 357,500 common shares were purchased and cancelled in the second half of 2018. 1,625,000 common shares were purchased and cancelled in the first half of the 2019 year, and 612,800 common shares were purchased and cancelled subsequent to June 30, 2019.

PHX Energy continues to use the NCIB as an additional tool to enhance total long-term shareholder returns in conjunction with management's disciplined capital allocation strategy.

(Stated in thousands of dollars except per share amounts, percentages and shares outstanding)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Operating Results	<i>(unaudited)</i>	<i>(unaudited)</i>		<i>(unaudited)</i>	<i>(unaudited)</i>	
Revenue	82,984	69,009	20	175,104	139,768	25
Net loss	(2,020)	(84)	n.m.	(3,087)	(4,335)	(29)
Loss per share – diluted	(0.04)	-	n.m.	(0.05)	(0.07)	(29)
Adjusted EBITDA ⁽¹⁾	10,995	10,013	10	22,426	16,781	34
Adjusted EBITDA per share – diluted ⁽¹⁾	0.19	0.17	12	0.38	0.29	31
Adjusted EBITDA as a percentage of revenue ⁽¹⁾	13%	15%		13%	12%	
Cash Flow						
Cash flows from operating activities	21,244	8,909	138	30,944	9,844	214
Funds from operations ⁽¹⁾	9,785	7,158	37	19,884	12,914	54
Funds from operations per share – diluted ⁽¹⁾	0.17	0.12	42	0.34	0.22	55
Capital expenditures	9,090	4,698	93	20,397	7,765	163
Financial Position (unaudited)				Jun 30, '19	Dec 31, '18	
Working capital				56,871	60,316	(6)
Long-term debt				16,309	11,821	38
Shareholders' equity				149,815	168,414	(11)
Common shares outstanding				56,383,720	57,963,720	(3)

n.m. – not meaningful

⁽¹⁾ Non-GAAP measure that does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other entities. Refer to non-GAAP measures section that follows the Outlook section of this MD&A.

Non-GAAP Measures

PHX Energy uses throughout this MD&A certain measures to analyze operational and financial performance that do not have standardized meanings prescribed under Canadian generally accepted accounting principles ("GAAP"). These non-GAAP measures include adjusted EBITDA, adjusted EBITDA per share, debt to covenant EBITDA, funds from operations, funds from operations per share and working capital. Management believes that these measures provide supplemental financial information that is useful in the evaluation of the Corporation's operations and are commonly used by other oil and natural gas service companies. Investors should be cautioned, however, that these measures should not be construed as alternatives to measures determined in accordance with GAAP as an indicator of PHX Energy's performance. The Corporation's method of calculating these measures may differ from that of other organizations, and accordingly, such measures may not be comparable. Please refer to the "Non-GAAP Measures" section following the Outlook section of this MD&A for applicable definitions and reconciliations.

Management's Discussion and Analysis

The following MD&A of the financial condition, results of operations, and cash flow of PHX Energy Services Corp. ("PHX Energy" or the "Corporation") should be read in conjunction with the Corporation's 2018 annual report, including the MD&A, and audited consolidated financial statements and the accompanying notes contained therein, and the Corporation's 2019 unaudited interim second quarter report, including the unaudited condensed consolidated financial statements and the accompanying notes contained therein. Readers can also obtain additional information on the Corporation including its Information Circular and Annual Information Form ("AIF") filed on SEDAR at www.sedar.com. This MD&A has been prepared taking into consideration information available up to and including July 31, 2019.

PHX Energy's Interim Financial Report for the three-month and six-month periods ended June 30, 2019 and 2018 has been prepared in accordance with International Financial Reporting Standards ("IFRS"). The MD&A and Interim Financial Report were reviewed by PHX Energy's Audit Committee and approved by PHX Energy's Board on July 31 2019.

Cautionary Statement Regarding Forward-Looking Information and Statements

This MD&A contains certain forward-looking information and statements within the meaning of applicable securities laws. The use of "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "could", "should", "can", "believe", "plans", "intends", "strategy" and similar expressions are intended to identify forward-looking information or statements.

The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. These statements and information involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements and information. The Corporation believes the expectations reflected in such forward-looking statements and information are reasonable, but no assurance can be given that these expectations will prove to be correct. Such forward-looking statements and information included in this MD&A should not be unduly relied upon. These forward-looking statements and information speak only as of the date of this MD&A.

In particular, forward-looking information and statements contained in this MD&A include, without limitation:

- Delivery of the outstanding capital commitments is expected to occur by the end of 2019.
- The 2019 capital expenditure budget is anticipated to be \$30 million.
- In the 2019-year, the Corporation expects to spend \$21 million growing the Corporation's fleet of drilling equipment and \$9 million to maintain the current fleet of drilling and other equipment.

- The Corporation anticipates that capital expenditures for the 2019-year will be allocated as follows: \$15 million towards performance drilling motors primarily relating to Atlas Motors, \$12 million on MWD systems, primarily relating to Velocity, and \$3 million relating to machinery and equipment, and collars.
- Planned Capital expenditures are expected to be financed from a combination of one or more of the following: cash flow from operations, the Corporation's unused credit facilities or equity, if necessary.

The above are stated under the headings: "Capital Spending", and "Cash Requirements for Capital Expenditures". In addition, statements contained within the Contractual Obligations, Business Risk and Outlook section of this report contains forward-looking statements.

In addition to other material factors, expectations and assumptions which may be identified in this MD&A and other continuous disclosure documents of the Corporation referenced herein, assumptions have been made in respect of such forward-looking statements and information regarding, among other things: the Corporation will continue to conduct its operations in a manner consistent with past operations; the general continuance of current industry conditions; anticipated financial performance, business prospects, impact of competition, strategies, the general stability of the economic and political environment in which the Corporation operates; exchange and interest rates; the continuance of existing (and in certain circumstances, the implementation of proposed) tax, royalty and regulatory regimes; the sufficiency of budgeted capital expenditures in carrying out planned activities; the availability and cost of labour and services and the adequacy of cash flow; debt and ability to obtain financing on acceptable terms to fund its planned expenditures, which are subject to change based on commodity prices; market conditions and future oil and natural gas prices; and potential timing delays. Although Management considers these material factors, expectations and assumptions to be reasonable based on information currently available to it, no assurance can be given that they will prove to be correct.

Readers are cautioned that the foregoing lists of factors are not exhaustive. Additional information on these and other factors that could affect the Corporation's operations and financial results are included in reports on file with the Canadian Securities Regulatory Authorities and may be accessed through the SEDAR website (www.sedar.com) or at the Corporation's website. The forward-looking statements and information contained in this MD&A are expressly qualified by this cautionary statement. The Corporation does not undertake any obligation to publicly update or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, except as may be required by applicable securities laws.

About PHX Energy Services Corp.

The Corporation, through its directional drilling subsidiary entities, provides horizontal and directional drilling technology and services to oil and natural gas producing companies in Canada, the US, Russia and Albania. PHX Energy also provides electronic drilling recorder (“EDR”) technology and services.

PHX Energy’s Canadian directional drilling operations are conducted through Phoenix Technology Services LP. The Corporation maintains its corporate head office, research and development, Canadian sales, service and operational centres in Calgary, Alberta. In addition, PHX Energy has a facility in Estevan, Saskatchewan. PHX Energy’s US operations, conducted through the Corporation’s wholly-owned subsidiary, Phoenix Technology Services USA Inc. (“Phoenix USA”), is headquartered in Houston, Texas. Phoenix USA has sales and service facilities in Houston, Texas; Denver, Colorado; Casper, Wyoming; Midland, Texas; Bellaire, Ohio; and Oklahoma City, Oklahoma. Internationally, PHX Energy has sales offices and service facilities in Albania and Russia, and administrative offices in Nicosia, Cyprus; Dublin, Ireland; and Luxembourg City, Luxembourg.

PHX Energy markets its EDR technology and services in Canada through its division, Stream Services (“Stream”), which has an office and operations center in Calgary, Alberta. EDR technology is marketed worldwide, outside Canada, through Stream’s wholly-owned subsidiary Stream Services International Inc.

The common shares of PHX Energy trade on the Toronto Stock Exchange under the symbol PHX.

Results of Operations

Three and Six-Month Periods Ended June 30, 2019

Revenue

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Revenue	82,984	69,009	20	175,104	139,768	25

For the three-month period ended June 30, 2019, the Corporation generated consolidated revenue of \$83 million as compared to \$69 million in the 2018-quarter, an increase of 20 percent primarily driven by higher revenue per day in PHX Energy's US segment. The average consolidated revenue per day, excluding the motor rental division in the US and the Stream division, in the 2019-quarter rose by 14 percent to \$14,181 relative to \$12,447 in the corresponding 2018-quarter. The higher revenue per day resulted from the greater volume of premiums and surcharges generated by high performance technologies and the strengthening of the US dollar relative to the 2018-quarter. Consolidated operating days increased 2 percent from 5,443 days in the 2018-quarter to 5,567 days in the 2019-quarter. Strong activity in the US operations was offset by weaker conditions in Canada, causing consolidated drilling activity for the Corporation to be relatively flat. For the three-month period ended June 30, 2019, US revenues represented 81 percent of consolidated revenue (2018 – 75 percent).

During the second quarter, the Western Texas Intermediate ("WTI") crude oil price was 12 percent lower than in the 2018-quarter averaging USD \$60/bbl (2018-quarter – USD \$68/bbl) and the Western Canadian Select ("WCS") oil prices also showed a 5 percent increase averaging CAD \$66/bbl (2018-quarter – CAD \$63/bbl). Both the US and Canadian industry's activity slowed quarter-over-quarter, however, the 25 percent decline in the Canadian rig count was far more severe than the 5 percent decrease in the US. There still remains a stark contrast between the two industry's rig count with an average of 989 rigs operating per day in the US and an average of 79 rigs operating per day in Canada. Throughout North America the vast majority of wells continued to be horizontal and directional representing 97 percent of all wells drilled in Canada and 95 percent of the average number of rigs operating per day in the US (Sources: Daily Oil Bulletin and Baker Hughes).

For the six-month period ended June 30, 2019, the Corporation realized consolidated revenue of \$175.1 million, a 25 percent increase, compared to the \$139.8 million in the same 2018-period. For the 2019-period, the average consolidated revenue per day, excluding the motor rental division in the US and the Stream division, was \$13,214 as compared to \$11,192 in the 2018-period, an increase of 18 percent. In the six-month period ended June 30, 2019 there were 12,592 operating days recorded rising 3 percent relative to 12,212 days in the corresponding 2018-period. Similar to the 2019 quarterly results, the improvement

in revenue for the six-month period ended June 30, 2019 was a result of high performance technology offerings and the strengthening of the US dollar in the 2019-period relative to 2018.

Operating Costs and Expenses

(Stated in thousands of dollars except percentages)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Direct costs	72,261	62,389	16	151,051	128,318	18
Gross profit as a percentage of revenue	13%	10%		14%	8%	
Depreciation & amortization drilling and other equipment (included in direct costs)	10,118	9,801	3	20,284	20,107	1
Depreciation & amortization right-of-use asset (included in direct costs)	878	-	n.m.	1,746	-	n.m.
Gross profit as percentage of revenue excluding depreciation & amortization	26%	24%		26%	23%	

n.m. – not meaningful

Direct costs are comprised of field and shop expenses, and include depreciation and amortization on the Corporation's equipment and right-of-use assets. Depreciation on right-of-use assets relate to the impact of adopting IFRS 16 Leases as at January 1, 2019, which required capitalizing the Corporation's office, shop and vehicle leases. For the three and six-month periods ended June 30, 2019, direct costs rose to \$72.3 million and \$151.1 million, respectively, from \$62.4 million and \$128.3 million in the corresponding 2018-periods. In both 2019-periods increased direct costs can be attributed to higher overall labour costs and a greater number of equipment repair expenses associated with increased activity in the US.

For both the three and six-month periods ended June 30, 2019, gross profit as a percent of revenue, excluding depreciation and amortization, was 26 percent, an increase compared to 24 percent and 23 percent in the respective 2018-periods. Improved profitability is mainly due to higher revenue per day in the US and Canadian segments.

(Stated in thousands of dollars except percentages)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Selling, general & administrative ("SG&A") costs	11,394	9,012	26	24,596	17,782	38
Cash-settled share-based payments (included in SG&A costs)	1,095	1,105	(1)	4,030	1,151	n.m.
Equity-settled share-based payments (included in SG&A costs)	215	399	(46)	399	859	(54)
Onerous contracts lease payment (included in SG&A costs)	-	(20)	n.m.	-	(148)	n.m.
SG&A costs excluding equity and cash-settled share-based payments and provision for onerous contracts as a percentage of revenue	12%	11%		12%	11%	

n.m. – not meaningful

For the three-month period ended June 30, 2019, SG&A costs were \$11.4 million, an increase of 26 percent compared to the \$9 million in respective 2018-quarter. The increases to SG&A was primarily due to higher personnel-related costs. For the six-month period ended June 30, 2019, SG&A costs were \$24.6 million relative to the \$17.8 million recognized in the 2018-period, a 38 percent increase. Higher SG&A costs for the six-month period ended June 30, 2019 relate to higher personnel costs and cash-settled share-based payments in the period.

Cash-settled share-based payments relate to the Corporation's Retention Award Plan and are measured at fair value. In both the second quarter of 2018 and 2019 cash-settled share-based payments totaled \$1.1 million. For the six-month period ended June 30, 2019, cash settled share-based payments increased to \$4 million as compared to \$1.2 million in the 2018-period, mostly due to fluctuations in the Corporation's share price in the 2019 and 2018- periods.

Equity-settled share-based payments relate to the amortization of the fair values of issued options by the Corporation using the Black-Scholes model. For the three and six-month periods ended June 30, 2019, equity-settled share-based payments were \$0.2 million and \$0.4 million, respectively, as compared to the corresponding \$0.4 million and \$0.9 million in the respective 2018-periods. Lower equity-settled share-based payments is a result of previously granted options that fully vested in the 2018-year.

Due to adoption of IFRS 16 Leases as of January 1, 2019, onerous contracts lease payments are no longer recorded.

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Research & development expense	880	799	10	1,780	1,670	7

Research and development ("R&D") expenditures for the three and six-month periods ended June 30, 2019 were \$0.9 million (2018 - \$0.8 million) and \$1.8 million (2018 - \$1.7 million), respectively. R&D costs primarily relate to personnel costs. In order to expand services PHX Energy continues to focus efforts on developing new technologies, improving reliability of equipment, and decreasing costs to operations.

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Finance expense	400	325	23	784	665	18
Finance expense lease liability	629	-	n.m.	1,275	-	n.m.

n.m. – not meaningful

Finance expenses relate to interest charges on the Corporation's long-term and short-term bank facilities. For the three and six-month periods ended June 30, 2019, finance charges rose to \$0.4 million (2018 - \$0.3 million) and \$0.8 million (2018 - \$0.7 million), respectively. Higher finance expenses in the above-mentioned periods is primarily due to higher long-term loans outstanding resulting from larger capital expenditures in the 2019-periods as compared to 2018-periods.

Finance expense lease liability relates to interest expenses incurred on lease liabilities, as a result of the adoption of IFRS 16 Leases in 2019.

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Net gain on disposition of drilling equipment	(1,596)	(3,073)	(2,876)	(3,851)
Foreign exchange losses (gains)	246	(88)	512	(217)
Provision for (Recovery of) bad debts	280	-	326	(8)
Other income	(1,070)	(3,161)	(2,038)	(4,076)

Net gain on disposition of drilling equipment typically result from insurance programs undertaken whereby proceeds for the lost equipment are at current replacement values, which are higher than the respective equipment's book value. The recognized gain is net of losses, which typically result from asset retirements that were made before the end of the equipment's useful life and self-insured downhole equipment losses. For the three and six-month periods ended June 30, 2019, the Corporation incurred a \$1.6 million and \$2.9 million gain on dispositions, respectively, which is lower compared to the \$3.1

million and \$3.9 million gain on dispositions realized in the respective 2018-periods. In the second quarter of 2019, there were fewer occurrences of downhole equipment losses and a higher number of asset retirements compared to the 2018-quarter.

Foreign exchange losses (gains) relate to unrealized and realized exchange losses in the period. For the three and six-month periods ended June 30, 2019, the Corporation recognized \$0.2 million and \$0.5 million in losses, respectively, relative to \$0.1 million and \$0.2 million gains in the corresponding 2018-periods. Losses in the 2019-periods primarily relate to settlement of US-denominated payables in the international segment and the revaluation of Canadian dollar denominated intercompany payables in the US.

Provision for bad debts for the three and six-month periods ended June 30, 2019 primarily relate to bad debt provisions for a few customers in the US division.

(Stated in thousands of dollars, except percentages)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Provision for (Recovery of) income taxes	510	(271)	744	(257)
Effective tax rates	n.m.	76%	n.m.	6%

n.m. – not meaningful

Provision for income taxes for the three and six-month periods ended June 30, 2019, were \$0.5 million and \$0.7 million, respectively, as compared to recovery of income taxes of \$0.3 million in both the comparable 2018-periods. Deferred taxes in the 2019-periods was impacted by unrecognized deferred tax assets with respect to deductible temporary differences in the Canadian jurisdictions, which were recognized in the corresponding 2018-periods.

Segmented Information

The Corporation reports three operating segments on a geographical basis throughout the Canadian provinces of Alberta, Saskatchewan, British Columbia, and Manitoba; throughout the Gulf Coast, Northeast and Rocky Mountain regions of the US; and internationally, in Russia and Albania.

Canada

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Revenue	10,664	12,687	(16)	35,528	40,662	(13)
Reportable segment loss before tax	(2,208)	(4,811)	(54)	(955)	(3,300)	(71)

In Canada, the second quarter is spring break-up period and typically activity levels are lower as compared to the other quarters of the year. For the three and six-month periods ended June 30, 2019, PHX Energy's Canadian revenues were \$10.7 million and \$35.5 million, respectively, in comparison to revenues of \$12.7 million and \$40.7 million in the same 2018-periods. Even though revenue per day increased for the three and six-month periods ended June 30, 2019 to \$8,860 (2018 - \$8,684) and \$8,642 (2018 - \$8,115), respectively, revenue declined mainly due to lower drilling activity in the Canadian division.

For the three-month period ended June 30, 2019, operating days declined 21 percent to 1,097 days, compared to 1,390 days in the relative 2018-quarter. The decline in the Canadian segment's activity is in line with slower industry activity. The industry's horizontal and directional drilling activity contracted 20 percent as measured by drilling days shrinking from 9,180 days in the 2018-quarter to 7,356 days in the 2019-quarter (Source: Daily Oil Bulletin).

During the second quarter of 2019, oil drilling, as measured by drilling days, represented approximately 39 percent of PHX Energy's Canadian activity and the Corporation remained active in the Montney, Wilrich, Charlie Lake, Duvernay, Cardium, and Notekiwini areas.

For the six-month period ended June 30, 2019, operating days declined 20 percent to 3,834 days, compared to 4,772 days in the same 2018-period. The Canadian industry activity declined sharper than PHX Energy's activity, dropping 31 percent to 21,884 horizontal and directional drilling days reported in the first half of 2019 as compared to 31,683 horizontal and directional drilling days in 2018 (Sources: Daily Oil Bulletin).

In the Canadian division, despite the decline in activity, profitability improved for the three and six-month periods ended June 30, 2019. Better profitability is mainly attributed to lower depreciation expense and overall costs in the 2019-periods as more drilling and other equipment was moved to the US division. Higher revenue per day also had a positive impact to improved profitability in the 2019-periods.

Stream Services

Included in the Canadian segment's revenues is the Stream division, which realized revenues in the three and six-month periods ending June 30, 2019 of \$0.9 million and \$2.4 million, respectively, as compared to \$0.6 million and \$1.9 million realized in the corresponding 2018-periods. The improvement in Stream's revenue is primarily driven by higher operating days, and in the three and six-month periods ended June 30, 2019 operating days increased to 1,644 days (2018 – 822 days) and 4,569 days (2018 – 2,741 days), respectively. This is partially offset by lower revenue per day due to higher share of lower rate services being provided in 2019. For the three and six-month period ended June 30, 2019, Stream's revenue per day was \$575 and \$525, respectively, comparatively revenue per day in the 2018-periods was \$750 and \$708.

As a result of higher operating days and disciplined cost management, reportable segment losses before tax decreased to \$0.4 million and \$0.8 million for the three and six-month periods ended June 30, 2019, respectively.

United States

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Revenue	67,137	51,647	30	130,133	89,714	45
Reportable segment income (loss) before tax	3,431	3,887	(12)	5,827	(281)	n.m.

n.m. – not meaningful

For the three-month period ended June 30, 2019, the US division achieved the highest quarterly revenue since the fourth quarter of 2014. US revenue in the 2019-quarter improved by 30 percent to \$67.1 million as compared to \$51.6 million in the corresponding 2018-quarter. Drilling activity increased by 11 percent in the quarter to 3,903 days compared to 3,523 days in the same 2018-quarter. In comparison, the US industry rig count decreased by 4 percent quarter-over-quarter with an average of 939 active horizontal and directional rigs per day in 2019 compared to an average of 981 active horizontal and directional rigs per day in the 2018-quarter (Source: Baker Hughes). PHX Energy's US division continues to outperform the industry as a result of the demand for the Corporation's high performance technologies, increased capacity of the fleet, superior operational performance of personnel and equipment, and targeted marketing efforts. For the three-month period ended June 30, 2019, revenue per day, excluding the Corporation's US motor rental division, rose to CAD \$16,409 relative to CAD \$14,477 in the corresponding 2018-quarter. The 13 percent increase to revenue per day is attributable to the premiums and surcharges generated by Corporation's high performance technologies and a strengthening of the US dollar. The US-denominated average revenue per day increased 9 percent quarter-over-quarter. Reportable segment income was \$3.4 million in the 2019-quarter down 12 percent when compared to the \$3.9 million in the 2018-quarter. This decrease was primarily due to a greater volume of drilling and other equipment utilized in the US division which resulted in a \$1.7 million increase to the depreciation expense quarter-over-quarter.

Horizontal and directional rigs represented 95 percent of the average number of US rigs running per day (2018 – 94 percent). The Permian basin continued to be the dominate play in the US industry, representing 46 percent of the average operating rigs per day in the 2019-quarter (2018 quarter – 45 percent); although, the Permian did see a decline in activity that was in line with the overall rate of decline in the US rig count. (Source: Baker Hughes). During the three-month period ended June 30, 2019, the Permian basin represented approximately 77 percent of the wells drilled by the Corporation and all of PHX Energy's US activity was oil well drilling. In addition to the Permian basin, Phoenix USA continued to be active in the Eagle Ford, Granite Wash, SCOOP/STACK, Marcellus, Bakken and Niobrara basins.

US revenue in the period grew to \$130.1 million, an increase of 45 percent as compared to the \$89.7 million in the same 2018-period. Consistent with the second quarter of 2019, for the six-month period ended June 30, 2019, the Corporation capitalized on high performance technologies attributing to higher operational days and higher revenue per day. Drilling activity for the six-month period ended June 30, 2019, increased 23 percent to 7,652 days as compared to 6,235 days in the same 2018-period. In comparison, US industry activity, as measured by the average number of horizontal and directional rigs running on a daily basis, was relatively flat with 960 rigs in the first half of 2019 as compared to an average of 942 rigs in the comparable 2018-period (Source: Baker Hughes). Permian activity represented 77 percent of Phoenix USA's activity in the first half of 2019. For the six-month period ended June 30, 2019, revenue per day, excluding the Corporation's motor rental division, was CAD \$16,181, which is 14 percent higher than the CAD \$14,204 in the 2018-period. For the six-month period ended June 30, 2019, the US-denominated revenue per day increased 9 percent versus the 2018-period. For the six-month period ended June 30, 2019, a reportable segment income of \$5.8 million was realized as compared to a reportable segment loss of \$0.3 million in the corresponding 2018-period. Higher profitability in the period is mainly attributed to the rise in activity levels and revenue per day.

International

(Stated in thousands of dollars)

	Three-month periods ended June 30,			Six-month periods ended June 30,		
	2019	2018	% Change	2019	2018	% Change
Revenue	5,183	4,675	11	9,443	9,392	1
Reportable segment income (loss) before tax	170	(30)	n.m.	65	(390)	n.m.

n.m. – not meaningful

For the three-month period ended June 30, 2019, the international segment's revenue was \$5.2 million, an 11 percent increase over the \$4.7 million in the 2018-quarter. The improvement in revenue in the 2019-quarter is mainly attributable to increased drilling activity in Albania. For the six-month period ended June 30, 2019, the international segment's revenue was \$9.4 million flat compared to the same 2018-period.

For the three-month period ended June 30, 2019, PHX Energy's Russia division recognized revenue of \$3.1 million as compared to \$3.8 million in the 2018-quarter. The division experienced lower activity in the region from some of its key clients resulting in lower operating days, 312 days, in the 2019-quarter compared to in the corresponding 2018-quarter, 428 days.

For the three-month period ended June 30, 2019, PHX Energy's Albania division achieved revenue of \$2.1 million as compared to \$0.8 million in the 2018-quarter. The Albania division was operating on three rigs in the second quarter of 2019 compared to one operational rig for most of the 2018-quarter with a second rig added in the latter half of that quarter. As a result, operating days increased to 256 days in the 2019-quarter relative to 103 days in the corresponding 2018-quarter.

The international segment recognized reportable segment income for the three and six-month periods ended June 30, 2019 of \$0.2 million (2018 - \$30,000 loss) and \$0.1 million (2018 - \$0.4 million loss), respectively. The improved margins in both 2019-periods were mainly due to higher activity levels in Albania.

Summary of Quarterly Results

(Stated in thousands of dollars except per share amounts)

	Jun-19	Mar-19	Dec-18	Sept-18	Jun-18	Mar-18	Dec-17	Sept-17
Revenue	82,984	92,121	92,335	85,033	69,009	70,759	60,660	65,396
Net income (loss)	(2,020)	(1,067)	(18,355)	3,743	(84)	(4,251)	(5,126)	(846)
Loss per share – basic	(0.04)	(0.02)	(0.32)	0.06	-	(0.07)	(0.09)	(0.01)
Loss per share – diluted	(0.04)	(0.02)	(0.32)	0.06	-	(0.07)	(0.09)	(0.01)
Adjusted EBITDA ⁽¹⁾	10,995	11,431	14,736	13,934	10,013	6,768	4,684	11,689
Funds from operations ⁽¹⁾	9,785	10,100	12,803	11,461	7,158	5,757	2,490	8,436

⁽¹⁾ Non-GAAP measure that does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other entities. Refer to non-GAAP measures section that follows the Outlook section of this MD&A.

Activity levels in western Canada vary considerably due to seasonal weather patterns. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As warm weather returns in the spring, the winter's frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. The duration of this "spring break-up" has a direct impact on the Corporation's activity levels. As a result, late March through May is typically the slowest time for activity in Canada, as such, the operating results of the Corporation vary on a quarterly basis. The Corporation's activity levels in the US and international regions are not impacted at the same level during this Canadian spring break-up period.

Liquidity

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Funds from operations	9,785	7,158	19,884	12,914

	June 30, '19	Dec. 31, '18
Working capital	56,871	60,316

In the second quarter and first half of 2019, mainly due to greater activity in the US segment and increased overall profitability, the Corporation generated higher funds from operations of \$9.8 million (2018 - \$7.2 million) and \$19.9 million (2018 - \$12.9 million), respectively.

As at June 30, 2019, the Corporation had working capital of \$56.9 million, which is \$3.4 million lower than the \$60.3 million reported at December 31, 2018, mainly due to lower trade and other receivables in the second quarter of 2019.

Investing Activities

For the three-month period ended June 30, 2019, PHX Energy used \$7.5 million of net cash in investing activities as compared to \$1.4 million of net cash from investing activities in 2018. During the 2019-quarter, PHX Energy received proceeds of \$3.5 million (2018 - \$5.3 million) primarily from the involuntary disposal of drilling equipment in well bores. In addition, the Corporation spent \$9.1 million on capital expenditures in the 2019-quarter compared to \$4.7 million in the 2018-quarter. 2019-quarter expenditures were comprised of:

- \$5.3 million in downhole performance drilling motors,
- \$3 million in MWD systems and spare components; and
- \$0.8 million in machining and equipment, RSS, and other assets.

The capital expenditure program undertaken in the period was financed generally from cash flow from operating activities. Of the total capital expenditures in the 2019-quarter \$5.5 million was used to grow the Corporation's fleet of drilling equipment and the remaining \$3.6 million was used to maintain the current fleet of drilling and other equipment.

The change in non-cash working capital balance of \$1.9 million (use of cash) for the three-month period ended June 30, 2019, relates to the net change in the Corporation's trade payables that are associated with the acquisition of capital assets. This compares to a \$0.8 million (source of cash) for the three-month period ended June 30, 2018.

Financing Activities

The Corporation reported cash flows used in financing activities of \$10.3 million in the three-month period ended June 30, 2019 as compared to \$6.5 million in the 2018-period. In the 2019-quarter the Corporation:

- repurchased \$4.7 million of shares under the NCIB,
- made repayments of \$4.9 million to its operating and syndicated facilities; and
- made payment of \$0.8 million towards its lease liability in line with the newly adopted IFRS 16 Leases standard.

Capital Resources

As of June 30, 2019, the Corporation had \$16.3 million drawn on its syndicated facility, \$6.6 million drawn on its operating facility, and a cash balance of \$7.4 million. As at June 30, 2019, the Corporation had approximately CAD \$41.4 million and USD \$4 million available to be drawn from its credit facilities. The credit facilities are secured by substantially all of the Corporation's assets.

As at June 30, 2019, the Corporation was in compliance with all its financial covenants. On July 29, 2019, the Corporation extended the maturity date of the syndicated loan agreement to December 11, 2022. The Corporation also increased the borrowing amounts in the syndicated facility from CAD \$48 million to CAD \$50 million and in the US operating facility from USD \$5 million to USD \$15 million.

Cash Requirements for Capital Expenditures

Historically, the Corporation has financed its capital expenditures and acquisitions through cash flows from operating activities, debt and equity. In the second quarter of 2019, the Board approved an increase to PHX Energy's 2019 capital expenditure program from \$25 million to \$30 million. The increase to the capital expenditure program was primarily dedicated to increasing the capacity of the Velocity fleet for activity in early 2020. The remainder of the increase to the capital expenditure program is anticipated to be allocated toward maintenance of the Velocity and performance motor drilling fleets, including Atlas Motors.

These planned expenditures are expected to be financed from a combination of one or more of the following: cash flow from operations, the Corporation's unused credit facilities or equity, if necessary. However, if a sustained period of market uncertainty and financial market volatility persists in 2019, the Corporation's activity levels, cash flows and access to credit may be negatively impacted, and the expenditure level would be reduced accordingly. Conversely, if future growth opportunities present themselves, the Corporation would look at expanding this planned capital expenditure amount.

Off-Balance Sheet Arrangements

The Corporation had no off-balance sheet arrangements as at June 30, 2019 and 2018.

Proposed Transactions

The Corporation reviews and evaluates any material business acquisitions or capital asset divestitures in the normal course of its operations.

Critical Accounting Estimates

The consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting. The Corporation's significant accounting policies are described in its annual audited consolidated financial statements for the year ended December 31, 2018. Management, in preparing these financial statements, is required to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses. These estimates and judgments are based upon assumptions that are considered reasonable under the circumstances. Actual results could differ from such estimates and judgments by a material amount. The significant judgments made by Management in applying the Corporation's accounting policies and the key sources of estimation uncertainty have not changed significantly since December 31, 2018.

Changes in Accounting Policies

These condensed consolidated interim financial statements have been prepared utilizing the same accounting policies and methods as the consolidated financial statements of the Corporation for the year ended December 31, 2018, unless specified.

a) New Standard – IFRS 16 Leases

In January 2016, the International Accounting Standards Board issued the final version of IFRS 16, Leases. IFRS 16 replaced the existing leases Standard, IAS 17 Leases, and related Interpretations. The Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., the lessee and the lessor). IFRS 16 introduced a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. Historically, operating lease expenses were charged to the statement of comprehensive income. The Standard also

contains enhanced disclosure requirements for lessees. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Other areas of the lease accounting model have been impacted, including the definition of a lease. The Corporation transitioned to IFRS 16 in accordance with the modified retrospective approach. Impacts of IFRS 16 prior to January 1, 2019 were not adjusted. The details of the changes in accounting policies are disclosed below.

i. **Definition of a Lease**

Previously, the Corporation determined whether an arrangement or an agreement contained a lease under IFRIC 4 *Determining Whether an Arrangement contains a Lease*. Beginning January 1, 2019, the Corporation determines whether an arrangement or an agreement contains a lease based on the new definition of a lease. Under IFRS 16, a contract is, or contains, a lease if the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

At inception of a contract, the Corporation assesses whether a contract is, or contains, a lease. To assess whether a contract conveys the right to control the use of an identified asset, the Corporation assesses whether:

- The contract involves the use of an identified asset, which may be specifically or implicitly stated, and the identified asset should be physically distinct or represents substantially all of the capacity of the asset. If the supplier has the substantive right to substitute the asset throughout the term of the contract, then the asset is not identified;
- The Corporation has the right to obtain substantially all of the economic benefits from use of the asset throughout the contract; and
- The Corporation has the right to direct the use of the identified asset throughout the contract. The Corporation has this right to direct how and for what purpose the asset is used. In addition, the Corporation has the right to operate the asset without the lessor or supplier having the right to change those operation instructions, or the Corporation designed the asset in a way that predetermines how and for what purpose it will be used.

On transition to IFRS 16, the Corporation elected to apply the practical expedient to grandfather the assessment of which transactions are leases. The Corporation applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed. Therefore, the definition of a lease under IFRS 16 has been applied only to contracts entered into or changed on or after January 1, 2019.

At inception or on reassessment of a contract that contains a lease component, the Corporation allocates the consideration in the contract to each lease and non-lease component on the basis of their relative stand-alone prices.

However, for leases of properties in which it is a lessee, the Corporation has elected not to separate non-lease components and will instead account for the lease and non-lease components as a single lease component.

ii. **As a Lessee**

The Corporation historically has leased assets such as properties, vehicles and office equipment.

As a lessee, the Corporation previously classified leases as operating or finance leases based on its assessment of whether the lease transferred substantially all of the risks and rewards of ownership. Historically all previous lease arrangements were classified as operating leases. Under IFRS 16, the Corporation recognizes right-of-use assets and lease liabilities for most leases, which is currently reflected on the Condensed Consolidated Statement of Financial Position.

However, the Corporation has elected to apply recognition exemptions to right-of-use assets and lease liabilities for some leases of low-value assets (e.g. office equipment), as well as for short-term leases or leases with terms less than 12 months or entered into on a month-to-month basis. The Corporation recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

For leases that do not qualify for the exemptions previously noted, the Corporation has recognized right-of-use asset and lease liability, respectively, on the Condensed Consolidated Statements of Financial Position.

The Corporation recognizes the right-of-use asset and lease liability at the lease commencement date. Lease liabilities were measured at the present value of the remaining lease payments, discounted at the incremental borrowing rate as at the lease commencement date. Right-of-use assets are measured at an amount equal to the lease-liability, adjusted for any lease payments made at or before commencement date, and initial direct costs incurred by the Corporation.

The Corporation used the following transitional practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

- The Corporation will rely on previous assessment of whether leases are onerous in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as an alternative to performing an impairment review and shall adjust the right-of-use asset at the date of the initial application by the amount of any provision for onerous leases recognized immediately before date of initial application.
- For leases previously classified as operating leases the Corporation has elected to measure the right-of-use asset as if IFRS 16 had always been applied since the commencement date of the lease, but discounted using the incremental borrowing rate at the date of initial application.

- Initial direct costs are excluded from the measurement of right-of-use assets at the date of initial application.
- When determining the lease term of contracts prior to January 1, 2019 the Corporation used hindsight.
- Discount rates for a portfolio of leases with reasonably similar characteristics will be the same if the discount rate is not implicit in the lease contract, and applying this standard will not result in any material differences.
- Leases with a term of 12 months or less will be excluded from the IFRS 16 lessee model and will be recognized directly in the statements of comprehensive income (loss) in line with historical treatment.
- Leases for which the lease term ends within 12 months of the date of initial application are recognized directly in the statements of comprehensive income (loss) in line with historical treatment.
- Leases of low-value items will be excluded from the IFRS 16 lessee model and recognized in line with historical treatment.

iii. As a Lessor

The Corporation is not required to make any adjustments on transition to IFRS 16 for leases in which it acts as a lessor except for a sub-lease. The Corporation accounted for its leases in accordance with IFRS 16 from the date of initial application.

The Corporation sub-leases some of its properties. Under IAS 17, the head lease and sub-lease contracts were classified as operating leases. The Corporation is required to assess the classification of a sub-lease with reference to the right-of-use asset, not the underlying asset. On transition, the Corporation reassessed the classification of its sub-leases and concluded that they qualify as a finance lease under IFRS 16.

iv. Impacts on Financial Statements

Impacts on transition

On transition to IFRS 16, as at January 1, 2019 the Corporation recognized additional right-of-use assets of \$33.9 million and lease liabilities of \$45.7 million. The impact of the transition on the Condensed Consolidated Statements of Financial Position is summarized below:

	January 1, 2019
Right-of-use assets ⁽¹⁾	33,882
Deferred tax assets	700
Lease liabilities ⁽²⁾	45,705
Deferred income	(1,300)
Provision for onerous contracts	(1,832)
Retained earnings	(7,991)

⁽¹⁾ Included in the right-of-use assets is a net investment in subleases of \$0.5 million.

⁽²⁾ Includes current and non-current lease liabilities.

When measuring lease liabilities, the Corporation discounted lease payments using the incremental borrowing rate at the commencement date of the lease. The weighted average rate applied was 6 percent.

	January 1, 2019
Operating lease commitments as at December 31, 2018	32,216
Discount using incremental borrowing rate as at January 1, 2019	(9,379)
Adjustments ⁽¹⁾	22,868
Lease liabilities recognized as at January 1, 2019	45,705

⁽¹⁾ Includes the impact of judgement applied with regard to lease terms in which the Corporation is a lessee that include renewals options; and includes exemptions including those for short-term and low-dollar value lease.

Impacts for the period

As a result of applying IFRS 16, the Corporation recognized right-of-use assets in the amount of \$32 million and lease liabilities of \$44 million as at June 30, 2019. Due to the addition of right-of-use asset and lease liabilities in 2019, the Corporation recognized depreciation expense and finance expense lease liability of \$1.7 million and \$1.3 million, respectively, for the six-month period ended June 30, 2019.

Business Risk Factors

The business risk factors applicable to the Corporation have not materially changed since December 31, 2018. Refer to the "Business Risk Factors" section of the MD&A in the PHX Energy's 2018 annual report.

Corporate Governance

This MD&A has been prepared by the Management of PHX Energy and it has been reviewed and approved by the Audit Committee and the Board of Directors of the Corporation. Additional information relating to the Corporation's Corporate Governance can be found in the Corporation's Annual Information Form and Information Circular in respect of its annual meeting of shareholders, each of which are annually filed on SEDAR at www.sedar.com.

Disclosure Controls and Procedures

The Corporation's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, disclosure controls and procedures to provide reasonable assurance that: (i) material information relating to the Corporation is made known to the Corporation's Chief Executive Officer and Chief Financial Officer by others, particularly during the period in which the interim filings are being prepared; and (ii) information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time period specified in securities legislation.

Internal Controls Over Financial Reporting

The Corporation's Chief Executive Officer and Chief Financial Officer have designed, or caused to be designed under their supervision, internal controls over financial reporting related to the Corporation, including its consolidated subsidiaries to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and preparation of financial statements together with other financial information for external purposes in accordance with IFRS.

The Corporation is required to disclose herein any change in the Corporation's internal controls over financial reporting that occurred during the period beginning on April 1, 2019 and ending on June 30, 2019 that has materially affected, or is reasonably likely to materially affect, the Corporation's internal controls over financial reporting. No material changes in the Corporation's internal controls over financial reporting were identified during such period that has materially affected, or are reasonably likely to materially affect, the Corporation's internal controls over financial reporting.

It should be noted that a control system, including the Corporation's disclosure and internal controls and procedures, no matter how well conceived, can provide only reasonable, but not absolute, assurance that the objectives of the control system will be met and it should not be expected that the disclosure and internal controls and procedures will prevent all errors or fraud.

Outstanding Corporation Share Data

<i>(In thousands of shares)</i>	As at July 31, 2019
Common shares outstanding	55,770,920
Dilutive securities:	
Options	5,296,101
Corporation shares – diluted	61,067,021

Outlook

In the second quarter, PHX Energy's focus on the US market and providing premium technologies continued to propel greater revenue and improved profitability. Adjusted EBITDA was the highest in the Corporation's history for a second quarter driven by strong US activity. Today, the majority of PHX Energy's activity is in the US market, with Phoenix USA representing 75 percent of the revenue in the first half of 2019 which is a strategic shift from five years prior when the US operations represented 54 percent of the revenue in the first half of the 2014-year.

In the US, despite the industry rig count slowing, PHX Energy continued to see growth, with both revenue and operating days increasing over the 2018-quarter. Revenue was the highest quarterly level since the fourth quarter in 2014 and these gains can be attributed to increased capacity in the high performance fleet, superior drilling results and targeted marketing efforts. Deliveries of new equipment are on schedule and are anticipated to arrive in upcoming quarters and into 2020. With this greater capacity and additional technologies in development, the Corporation is optimistic that this positive momentum will continue in the US.

The second quarter is typically a slower period in Canada due to the spring break-up period, however, the persisting challenges made the second quarter of 2019 the slowest in many years for both the Corporation and the industry. Without any firm resolution for the issues surrounding the industry and the ambiguity around the energy sector, PHX Energy believes the outlook for Canada is at a standstill. GMP First Energy states that, "In the context of history, the activity forecast is putrid with both 2019e and 2020e in the bottom quartile of the last 56 years" (Source: GMP First Energy, Energy Service Update - July 8, 2019). Despite this industry environment, PHX Energy remains committed to delivering solutions, including premium technologies, to its clients that will aide them in their efforts to operate in this ongoing industry recession. Currently the Canadian rig count is approximately 40 percent lower than at this time last year, and this slower activity level is anticipated to impact the Corporation's activity in upcoming quarters.

Activity levels in PHX Energy's international operations remained steady throughout the second quarter. The Corporation focused on the MWD rental business in Russia and Phoenix Albania continued to operate on three rigs. The increased activity level in Albania aided the increased profitability quarter-over-quarter in the international segment.

Technology Update

As the industry demands greater efficiencies, the Corporation remains strategically focused on developing, manufacturing and deploying differentiating technology. Today the Corporation offers Atlas High Performance Motors, the Velocity Real-Time System and PowerDrive Orbit RSS, and is expanding upon this offering by developing enhancements to these products and new technologies.

Downhole technologies, including those in the Corporation's fleet, have become increasingly impactful on the overall efficiency and costs of a drilling project. These technologies drive faster drilling rates and more precise well paths in addition to delivering other advantages. These new capabilities are instrumental for operators to reduce the number of days they need to drill longer and deeper wells which reduces their overall drilling costs as the majority of the services provided on a drilling project are based on day rates. The positive impact that PHX Energy's high performance technologies have on a drilling projects' efficiency is proven by the operational records that are now being frequently achieved. Examples of these records include the fastest rate of drilling in a particular area and the most meters drilled in a set period of time. This performance further solidifies PHX Energy's reputation as a leading technology provider and the Corporation remains strategically focused on furthering its competitive position.

PHX Energy has built a strong financial position, maintaining historically low debt levels and generating free cash flow in the quarter while it continues to invest in technology development. The North American industry remains divided, and PHX Energy will continue to leverage areas of strength, such as the US market and its high performance technologies to strive towards new financial and operational benchmarks.

Michael Buker, President
July 31, 2019

Non-GAAP Measures

Adjusted EBITDA

Adjusted EBITDA, defined as earnings before finance expense and finance expense lease liability, income taxes, depreciation and amortization, impairment losses on goodwill and intangible assets, equity share-based payments, and unrealized foreign exchange gains or losses, does not have a standardized meaning and is not a financial measure that is recognized under GAAP. However, Management believes that adjusted EBITDA provides supplemental information to net earnings that is useful in evaluating the results of the Corporation's principal business activities before considering certain charges, how it was financed and how it was taxed in various countries. Investors should be cautioned, however, that adjusted EBITDA should not be construed as an alternative measure to net earnings determined in accordance with GAAP. PHX Energy's method of calculating adjusted EBITDA may differ from that of other organizations and, accordingly, its adjusted EBITDA may not be comparable to that of other companies.

The following is a reconciliation of net earnings to adjusted EBITDA:

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Net loss	(2,020)	(84)	(3,087)	(4,335)
Add (deduct):				
Depreciation and amortization drilling and other equipment	10,118	9,801	20,284	20,107
Depreciation and amortization right-of-use asset	878	-	1,746	-
Provision for (Recovery of) income taxes	510	(271)	744	(257)
Finance expense	400	325	784	665
Finance expense lease liability	629	-	1,275	-
Equity-settled share-based payments	215	399	399	859
Unrealized foreign exchange (gain) loss	265	(157)	281	(258)
Adjusted EBITDA as reported	10,995	10,013	22,426	16,781

Adjusted EBITDA per share - diluted is calculated using the treasury stock method whereby deemed proceeds on the exercise of the share options are used to reacquire common shares at an average share price. The calculation of adjusted EBITDA per share on a dilutive basis does not include anti-dilutive options.

Funds from Operations

Funds from operations is defined as cash flows generated from operating activities before changes in non-cash working capital, interest paid, and income taxes paid. This non-GAAP measure does not have a standardized meaning and is not a financial measure recognized under GAAP. Management uses funds from operations as an indication of the Corporation's ability to generate funds from its operations before considering changes in working capital balances and interest and taxes paid. Investors should be cautioned, however, that this financial measure should not be construed as an alternative measure to cash flows from operating activities determined in accordance with GAAP. PHX Energy's method of calculating funds from operations may differ from that of other organizations and, accordingly, it may not be comparable to that of other companies.

The following is a reconciliation of cash flows from operating activities to funds from operations:

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Cash flows from operating activities	21,244	8,909	30,944	9,844
Add (deduct):				
Changes in non-cash working capital	(11,436)	(1,962)	(11,454)	3,126
Interest paid	218	120	495	348
Income taxes paid (received)	(241)	91	(101)	(404)
Funds from (used in) operations	9,785	7,158	19,884	12,914

Funds from operations per share - diluted is calculated using the treasury stock method whereby deemed proceeds on the exercise of the share options are used to reacquire common shares at an average share price. The calculation of funds from operations per share on a dilutive basis does not include anti-dilutive options.

Debt to Covenant EBITDA Ratio

Debt is represented by loans and borrowings. Covenant EBITDA, for purposes of the calculation of this covenant ratio, is represented by net earnings for a rolling four quarter period, adjusted for finance expense and finance expense lease liability, provision for income taxes, depreciation and amortization, equity-settled share-based payments, impairment losses on goodwill and intangible assets, onerous contracts, and IFRS 16 adjustment to restate cash payments to expense, subject to the restrictions provided in the amended credit agreement.

Working Capital

Working capital is defined as the Corporation's current assets less its current liabilities and is used to assess the Corporation's short-term liquidity. This non-GAAP measure does not have a standardized meaning and is not a financial measure recognized under GAAP. Management uses working capital to provide insight as to the Corporation's ability to meet obligations as at the reporting date. PHX Energy's method of calculating working capital may differ from that of other organizations and, accordingly, it may not be comparable to that of other companies.

Definitions

When the Corporation refers to operating days throughout this document, it is referring to the billable days on which PHX Energy is providing services to the client at the rig site. Average operating revenue per day is calculated by dividing revenue by the number of operating days. Average consolidated revenue per day is calculated by dividing consolidated revenue by the consolidated number of operating days.

Condensed Consolidated Statements of Financial Position

(unaudited)

	June 30, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 7,405,638	\$ 3,643,418
Trade and other receivables	80,372,412	103,987,716
Inventories	29,864,168	27,558,003
Prepaid expenses	3,913,752	2,428,221
Current tax assets	80,882	625,964
Total current assets	121,636,852	138,243,322
Non-current assets:		
Drilling and other equipment (Note 6)	90,229,376	94,164,880
Right-of-use asset (Note 3)	32,037,115	-
Intangible assets	20,869,496	22,301,680
Goodwill	8,876,351	8,876,351
Deferred tax assets	710,953	594,049
Total non-current assets	152,723,291	125,936,960
Total assets	\$ 274,360,143	\$ 264,180,282
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Operating facility (Note 7)	\$ 6,558,245	\$ 13,348,562
Lease liability (Note 3)	2,785,457	-
Trade and other payables	55,422,171	64,578,428
Total current liabilities	64,765,873	77,926,990
Non-current liabilities:		
Lease liability (Note 3)	41,200,714	-
Loans and borrowings (Note 7)	16,308,700	11,821,000
Deferred tax liability	2,269,585	2,886,606
Provision for onerous contracts (Note 3)	-	1,832,000
Deferred income (Note 3)	-	1,300,007
Total non-current liabilities	59,778,999	17,839,613
Equity:		
Share capital (Note 8a)	260,545,530	265,760,391
Contributed surplus	10,988,213	10,631,982
Retained earnings	(136,462,917)	(125,385,208)
Accumulated other comprehensive income	14,744,445	17,406,514
Total equity	149,815,271	168,413,679
Total liabilities and equity	\$ 274,360,143	\$ 264,180,282

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Comprehensive Income / Loss

(unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Revenue	\$ 82,983,644	\$ 69,009,023	\$ 175,104,348	\$ 139,767,577
Direct costs	72,260,718	62,388,547	151,050,936	128,318,004
Gross profit	10,722,926	6,620,476	24,053,412	11,449,573
Expenses:				
Selling, general and administrative expenses	11,394,219	9,011,684	24,596,157	17,782,409
Research and development expenses	880,017	799,281	1,779,603	1,669,611
Finance expense	400,025	325,244	783,625	664,971
Finance expense lease liability (Note 3)	628,522	-	1,274,683	-
Other income (Note 9)	(1,069,532)	(3,161,398)	(2,037,788)	(4,076,017)
	12,233,251	6,974,811	26,396,280	16,040,974
Loss before income taxes	(1,510,325)	(354,335)	(2,342,868)	(4,591,401)
Provision for (Recovery of) income taxes				
Current	120,312	2,071,290	468,784	1,926,457
Deferred	389,463	(2,341,955)	275,413	(2,183,188)
	509,775	(270,665)	744,197	(256,731)
Net loss	(2,020,100)	(83,670)	(3,087,065)	(4,334,670)
Other comprehensive income (loss)				
Foreign currency translation	(1,803,995)	649,403	(2,662,069)	3,295,370
Total comprehensive income (loss) for the period	\$ (3,824,095)	\$ 565,733	\$ (5,749,134)	\$ (1,039,300)
Loss per share – basic	\$ (0.04)	\$ -	\$ (0.05)	\$ (0.07)
Loss per share – diluted	\$ (0.04)	\$ -	\$ (0.05)	\$ (0.07)

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Changes in Equity

(unaudited)

Six-month period ended	Share Capital		Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
June 30, 2019	Number	Amount (\$)				
Balance, December 31, 2018	57,963,720	\$ 265,760,391	\$ 10,631,982	\$ 17,406,514	\$ (125,385,208)	\$ 168,413,679
Adjustment Initial application of IFRS 16	-	-	-	-	(7,990,644)	(7,990,644)
Net issuance of share capital	45,000	87,750	-	-	-	87,750
Common Shares repurchased	(1,625,000)	(5,345,437)	-	-	-	(5,345,437)
Share-based payments	-	-	399,057	-	-	399,057
Fair value of options exercised	-	42,826	(42,826)	-	-	-
Net loss	-	-	-	-	(3,087,065)	(3,087,065)
Foreign currency translation	-	-	-	(2,662,069)	-	(2,662,069)
Balance, June 30, 2019	56,383,720	\$ 260,545,530	10,988,213	14,744,445	(136,462,917)	149,815,271

Six-month period ended	Share Capital		Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Total Equity
June 30, 2018	Number	Amount (\$)				
Balance, December 31, 2017	58,397,887	\$ 266,838,036	\$ 9,315,926	\$ 11,822,389	\$ (106,438,399)	\$ 181,537,952
Common Shares repurchased	(125,000)	(237,500)	-	-	-	(237,500)
Share-based payments	-	-	858,796	-	-	858,796
Net loss	-	-	-	-	(4,334,670)	(4,334,670)
Foreign currency translation	-	-	-	3,295,370	-	3,295,370
Balance, June 30, 2018	58,272,887	\$ 266,600,536	10,174,722	15,117,759	(110,773,069)	181,119,948

See accompanying notes to unaudited condensed consolidated interim financial statements.

Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Cash flows from operating activities:				
Net loss	\$ (2,020,100)	\$ (83,670)	\$ (3,087,065)	\$ (4,334,670)
Adjustments for:				
Depreciation and amortization	10,117,493	9,801,024	20,284,764	20,107,270
Depreciation and amortization right-of-use asset	878,319	-	1,745,522	-
Provision for (Recovery of) income taxes	509,775	(270,665)	744,197	(256,731)
Unrealized foreign exchange loss (gain)	264,934	(157,362)	281,009	(258,431)
Gain on disposition of drilling equipment	(1,596,318)	(3,072,595)	(2,876,496)	(3,851,254)
Equity-settled share-based payments	215,100	398,594	399,057	858,796
Finance expense	400,025	325,244	783,625	664,971
Provision for (Recovery of) bad debts	279,567	-	326,138	(7,888)
Provision for inventory obsolescence	735,901	271,846	1,283,302	207,108
Provision for onerous contracts	-	(20,000)	-	(148,000)
Amortization of deferred income	-	(33,333)	-	(66,666)
Interest paid	(217,750)	(120,348)	(495,288)	(347,891)
Income taxes received (paid)	240,811	(91,368)	100,871	404,123
Change in non-cash working capital	11,436,637	1,961,562	11,454,051	(3,126,281)
Net cash from operating activities	21,244,394	8,908,929	30,943,687	9,844,456
Cash flows from investing activities:				
Proceeds on disposition of drilling equipment	3,510,292	5,261,241	6,044,065	7,968,105
Acquisition of drilling and other equipment	(9,090,137)	(4,698,055)	(20,396,683)	(7,764,625)
Acquisition of intangible assets	-	(2,902)	-	(6,598)
Change in non-cash working capital	(1,958,066)	807,860	(3,713,201)	(1,199,610)
Net cash from (used in) investing activities	(7,537,911)	1,368,144	(18,065,819)	(1,002,728)
Cash flows from financing activities:				
Proceeds from (Repayment of) operating facility	(2,196,552)	(3,453,314)	(6,790,317)	628,165
Repurchase of shares under the NCIB	(4,674,837)	-	(5,345,437)	(237,500)
Proceeds from (Repayment of) loans and borrowings	(2,700,200)	(3,000,000)	4,487,700	(5,000,000)
Payments of Lease Liability	(760,281)	-	(1,555,344)	-
Proceeds from issuance of share capital	-	-	87,750	-
Net cash used in financing activities	(10,331,870)	(6,453,314)	(9,115,648)	(4,609,335)
Net increase in cash and cash equivalents	3,374,613	3,823,759	3,762,220	4,232,393
Cash and cash equivalents, beginning of period	4,031,025	4,531,173	3,643,418	4,122,539
Cash and cash equivalents, end of period	\$ 7,405,638	\$ 8,354,932	\$ 7,405,638	\$ 8,354,932

See accompanying notes to unaudited condensed consolidated interim financial statements.

Notes to the Condensed Consolidated Financial Statements

For the three and six-month periods ended June 30, 2019 and 2018

In Canadian dollars (unaudited)

1. Reporting Entity

PHX Energy is a publicly-traded Corporation listed on the Toronto Stock Exchange ("TSX") under the symbol "PHX". The Corporation's registered office is at Suite 1400, 250 – 2nd Street SW Calgary, Alberta Canada.

The Corporation, through its subsidiaries, provides horizontal and directional drilling services, as well as web-based remote electronic drilling recorder ("EDR") technology and services, to oil and natural gas exploration and development companies in Canada, United States, Albania, and Russia. The Corporation also develops and manufactures technologies that are made available for internal operational use.

The condensed consolidated interim financial statements include the accounts of the Corporation and its wholly owned subsidiaries.

2. Basis of Preparation

a) Statement of Compliance

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting. The condensed consolidated interim financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the consolidated financial statements of the Corporation as at and for the year ended December 31, 2018.

These condensed consolidated interim financial statements were authorized by the Board of Directors on July 31, 2019.

b) Basis of Measurement

The condensed consolidated interim financial statements have been prepared on a going concern basis and use the historical cost basis except for liabilities for cash-settled share-based payment arrangements, which are measured at fair value and are included in trade and other payables in the statement of financial position.

c) Functional and Presentation Currency

These condensed consolidated interim financial statements are presented in Canadian dollars ("CAD"), which is the Corporation's functional currency.

d) Use of Estimates and Judgments

The preparation of the condensed consolidated interim financial statements in conformity with International Financial Reporting Standards ("IFRS") requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

In preparing these condensed consolidated interim financial statements, the significant judgments made by Management in applying the Corporation's accounting policies and the key sources of estimation uncertainty have not changed significantly since December 31, 2018.

3. Significant Accounting Policies

These condensed consolidated interim financial statements have been prepared utilizing the same accounting policies and methods as the consolidated financial statements of the Corporation for the year ended December 31, 2018, unless specified.

a) New Standard – IFRS 16 Leases

In January 2016, the International Accounting Standards Board issued the final version of IFRS 16, Leases. IFRS 16 replaced the existing leases Standard, IAS 17 Leases, and related Interpretations. The Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e., the lessee and the lessor). IFRS 16 introduced a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. Historically, operating lease expenses were charged to the statement of comprehensive income. The Standard also contains enhanced disclosure requirements for lessees. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Other areas of the lease accounting model have been impacted, including the definition of a lease. The Corporation transitioned to IFRS 16 in accordance with the modified retrospective approach. Impacts of IFRS 16 prior to January 1, 2019 were not adjusted. The details of the changes in accounting policies are disclosed below.

i. Definition of a Lease

Previously, the Corporation determined whether an arrangement or an agreement contained a lease under IFRIC 4 *Determining Whether an Arrangement contains a Lease*. Beginning January 1, 2019, the Corporation determines whether an arrangement or an agreement contains a lease based on the new definition of a lease. Under IFRS 16, a contract is, or contains, a lease if the contract conveys a right to control the use of an identified asset for a period of time in exchange for consideration.

At inception of a contract, the Corporation assesses whether a contract is, or contains, a lease. To assess whether a contract conveys the right to control the use of an identified asset, the Corporation assesses whether:

- The contract involves the use of an identified asset, which may be specifically or implicitly stated, and the identified asset should be physically distinct or represents substantially all of the capacity of the asset. If the supplier has the substantive right to substitute the asset throughout the term of the contract, then the asset is not identified;
- The Corporation has the right to obtain substantially all of the economic benefits from use of the asset throughout the contract; and
- The Corporation has the right to direct the use of the identified asset throughout the contract. The Corporation has this right to direct how and for what purpose the asset is used. In addition, the Corporation has the right to operate the asset without the lessor or supplier having the right to change those operation instructions, or the Corporation designed the asset in a way that predetermines how and for what purpose it will be used.

On transition to IFRS 16, the Corporation elected to apply the practical expedient to grandfather the assessment of which transactions are leases. The Corporation applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed. Therefore, the definition of a lease under IFRS 16 has been applied only to contracts entered into or changed on or after January 1, 2019.

At inception or on reassessment of a contract that contains a lease component, the Corporation allocates the consideration in the contract to each lease and non-lease component on the basis of their relative stand-alone prices. However, for leases of properties in which it is a lessee, the Corporation has elected not to separate non-lease components and will instead account for the lease and non-lease components as a single lease component.

ii. As a Lessee

The Corporation historically has leased assets such as properties, vehicles and office equipment.

As a lessee, the Corporation previously classified leases as operating or finance leases based on its assessment of whether the lease transferred substantially all of the risks and rewards of ownership. Historically all previous lease arrangements were classified as operating leases. Under IFRS 16, the Corporation recognizes right-of-use assets and lease liabilities for most leases, which is currently reflected on the Condensed Consolidated Statement of Financial Position.

However, the Corporation has elected to apply recognition exemptions to right-of-use assets and lease liabilities for some leases of low-value assets (e.g. office equipment), as well as for short-term leases or leases with terms less than 12 months or entered into on a month-to-month basis. The Corporation recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

For leases that do not qualify for the exemptions previously noted, the Corporation has recognized right-of-use asset and lease liability, respectively, on the Condensed Consolidated Statements of Financial Position.

The Corporation recognizes the right-of-use asset and lease liability at the lease commencement date. Lease liabilities were measured at the present value of the remaining lease payments, discounted at the incremental borrowing rate as at the lease commencement date. Right-of-use assets are measured at an amount equal to the lease-liability, adjusted for any lease payments made at or before commencement date, and initial direct costs incurred by the Corporation.

The Corporation used the following transitional practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

- The Corporation will rely on previous assessment of whether leases are onerous in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets as an alternative to performing an impairment review and shall adjust the right-of-use asset at the date of the initial application by the amount of any provision for onerous leases recognized immediately before date of initial application.
- For leases previously classified as operating leases the Corporation has elected to measure the right-of-use asset as if IFRS 16 had always been applied since the commencement date of the lease, but discounted using the incremental borrowing rate at the date of initial application.
- Initial direct costs are excluded from the measurement of right-of-use assets at the date of initial application.
- When determining the lease term of contracts prior to January 1, 2019 the Corporation used hindsight.

- Discount rates for a portfolio of leases with reasonably similar characteristics will be the same if the discount rate is not implicit in the lease contract, and applying this standard will not result in any material differences.
- Leases with a term of 12 months or less will be excluded from the IFRS 16 lessee model and will be recognized directly in the statements of comprehensive income (loss) in line with historical treatment.
- Leases for which the lease term ends within 12 months of the date of initial application are recognized directly in the statements of comprehensive income (loss) in line with historical treatment.
- Leases of low-value items will be excluded from the IFRS 16 lessee model and recognized in line with historical treatment.

iii. As a Lessor

The Corporation is not required to make any adjustments on transition to IFRS 16 for leases in which it acts as a lessor except for a sub-lease. The Corporation accounted for its leases in accordance with IFRS 16 from the date of initial application.

The Corporation sub-leases some of its properties. Under IAS 17, the head lease and sub-lease contracts were classified as operating leases. The Corporation is required to assess the classification of a sub-lease with reference to the right-of-use asset, not the underlying asset. On transition, the Corporation reassessed the classification of its sub-leases and concluded that they qualify as a finance lease under IFRS 16.

iv. Impacts on Financial Statements

Impacts on transition

On transition to IFRS 16, as at January 1, 2019 the Corporation recognized additional right-of-use assets of \$33.9 million and lease liabilities of \$45.7 million. The impact of the transition on the Condensed Consolidated Statements of Financial Position is summarized below:

	January 1, 2019
Right-of-use assets ⁽¹⁾	33,882
Deferred tax assets	700
Lease liabilities ⁽²⁾	45,705
Deferred income	(1,300)
Provision for onerous contracts	(1,832)
Retained earnings	(7,991)

⁽¹⁾ Included in the right-of-use assets is a net investment in subleases of \$0.5 million.

⁽²⁾ Includes current and non-current lease liabilities.

When measuring lease liabilities, the Corporation discounted lease payments using the incremental borrowing rate at the commencement date of the lease. The weighted average rate applied was 6 percent.

	January 1, 2019
Operating lease commitments as at December 31, 2018	32,216
Discount using incremental borrowing rate as at January 1, 2019	(9,379)
Adjustments ⁽¹⁾	22,868
Lease liabilities recognized as at January 1, 2019	45,705

⁽¹⁾ Includes the impact of judgement applied with regard to lease terms in which the Corporation is a lessee that include renewals options; and includes exemptions including those for short-term and low-dollar value lease.

Impacts for the period

As a result of applying IFRS 16, the Corporation recognized right-of-use assets in the amount of \$32.0 million and lease liabilities of \$44.0 million as at June 30, 2019. Due to the addition of right-of-use asset and lease liabilities in 2019, the Corporation recognized depreciation expense and finance expense lease liability of \$1.7 million and \$1.3 million, respectively, for the six-month period ended June 30, 2019.

4. Operating Segments

The Corporation provides horizontal and directional drilling services as well as EDR services to the oil and natural gas exploration and development companies. PHX Energy's reportable segments have been aligned geographically as follows:

Information about reportable segments*(Stated in thousands of dollars)*

	Canada		United States		International		Total	
Three-month periods ended June 30,	2019	2018	2019	2018	2019	2018	2019	2018
Drilling services revenue	9,719	12,071	67,137	51,647	5,183	4,675	82,039	68,393
EDR rental revenue	945	616	-	-	-	-	945	616
Total revenue	10,664	12,687	67,137	51,647	5,183	4,675	82,984	69,009
Reportable segment profit (loss) before income taxes	(2,208)	(4,811)	3,431	3,887	170	(30)	1,393	(954)

(Stated in thousands of dollars)

	Canada		United States		International		Total	
Six-month periods ended June 30,	2019	2018	2019	2018	2019	2018	2019	2018
Drilling services revenue	33,130	38,724	130,133	89,714	9,443	9,392	172,706	137,830
EDR rental revenue	2,398	1,938	-	-	-	-	2,398	1,938
Total revenue	35,528	40,662	130,133	89,714	9,443	9,392	175,104	139,768
Reportable segment profit (loss) before income taxes	(955)	(3,300)	5,827	(281)	65	(390)	4,937	(3,971)

(Stated in thousands of dollars)

	Canada		United States		International		Total	
As at June 30,	2019	2018	2019	2018	2019	2018	2019	2018
Drilling and other equipment	23,465	35,425	61,242	42,485	5,522	7,839	90,229	85,749
Goodwill	8,876	8,876	-	-	-	-	8,876	8,876

Reconciliation of reportable segment profit and other material items*(Stated in thousands of dollars)*

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Reportable segment loss before income taxes	1,393	(954)	4,937	(3,971)
Corporate:				
Selling, general and administrative expenses	2,064	1,437	5,479	2,361
Research and development expenses	880	799	1,780	1,670
Finance expense	400	325	784	665
Finance expense lease liability	629	-	1,275	-
Other income	(1,070)	(3,161)	(2,038)	(4,076)
Loss before income taxes	(1,510)	(354)	(2,343)	(4,591)

5. Seasonality of Operations

A portion of the Corporation's operations are carried out in western Canada. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As warm weather returns in the spring, the winter's frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. The duration of this "spring break-up" has a direct impact on the Corporation's activity levels. In addition, many exploration and production areas in northern Canada are accessible only in winter months when the ground is frozen enough to support equipment. The timing of freeze-up and spring break-up affects the ability to move equipment in and out of these areas. As a result, late March through May is traditionally the Corporation's least active time, and as such the operating results of the Corporation will vary on a quarterly basis.

6. Drilling and Other Equipment

a) Acquisitions and Disposals

During the six-month period ended June 30, 2019, the Corporation acquired assets with a cost of \$20.4 million (2018 - \$7.8 million).

Assets with a carrying amount of \$3.2 million (2018 - \$4.1 million) were disposed of as a result of tools lost down hole and scrapped assets, resulting in a net gain on disposition of \$2.9 million (2018 - \$3.9 million), which is included in other income in the condensed consolidated statement of comprehensive income.

b) Capital Commitments

As at June 30, 2019, the Corporation has commitments to purchase drilling and other equipment for \$6.3 million; delivery is expected to occur by the end of 2019.

7. Loans and Borrowings

(Stated in thousands of dollars)

	Currency	Amount of Facility	Date of Maturity	Currency	Carrying Amount at June 30, 2019	Currency	Carrying Amount at December 31, 2018
Operating Facility	CAD	15,000	Due on demand	CAD	6,558	CAD	13,349
Syndicated Facility	CAD	48,000	December 11, 2020	CAD	15,000	CAD	5,000
US Operating Facility	USD	5,000	December 11, 2020	USD	1,000	USD	5,000

Under the syndicated loan agreement, the Corporation is required to maintain certain financial covenants. As at June 30, 2019 the Corporation was in compliance with all its financial covenants as follows:

Ratio	Covenant	June 30, 2019
Debt to covenant EBITDA	< 3.0x	0.48
Interest coverage ratio	> 3.0x	36.25

In January 2019, the Corporation amended its syndicated loan agreement in connection with the effect of IFRS 16. The calculation relating to financial covenants shall be made with regard to generally accepted accounting principles in effect on December 31, 2018, thus negating IFRS 16.

On July 29, 2019, the Corporation extended the maturity date of the syndicated loan agreement to December 11, 2022. The Corporation also increased the borrowing amounts in the syndicated facility from CAD \$48.0 million to CAD \$50.0 million and in the US operating facility from USD \$5.0 to USD \$15.0 million.

8. Share Capital

a) Authorized and Issued Shares

The Corporation is authorized to issue an unlimited number of shares.

	Number		Amount
Balance as at January 1, 2018	58,397,887	\$	266,838,036
Common Shares repurchased	(482,500)		(1,207,324)
Issued shares pursuant to share option plan	48,333		129,679
Balance as at December 31, 2018	57,963,720	\$	265,760,391
Common Shares repurchased	(1,625,000)		(5,345,437)
Issued shares pursuant to share option plan	45,000		130,576
Balance as at June 30, 2019	56,383,720	\$	260,545,530

b) Share Option Program (Equity-Settled)

PHX Energy has a share option program that entitles key management personnel and other employees to purchase common shares in the Corporation. Grants under the plan vest as to one-third 6 months from the grant date, one-third 18 months from grant date and one-third 30 months from grant date. In accordance with these programs, options are exercisable using the five-day weighted-average trading price of the common shares ending immediately prior to the date of grant, or in the case of a US option holder, the trading price of the common shares ending immediately prior to the date of grant. The options have a term of five years.

Summary of option grants in 2019

Number	Exercise Price	Expiration Date	Fair Value
200,000	\$ 2.81	March 8, 2024	\$ 1.22
50,000	2.83	March 8, 2024	1.21
250,000			

The Corporation values all of its share options using the Black-Scholes model. The Corporation's determination of fair value of options on the date of grant is affected by the Corporation's share price as well as assumptions regarding a number of variables. For the options granted during 2019 these variables include, but are not limited to, the Corporation's expected share price volatility over the term of the options of 56 percent, forfeiture rate of nil, and a risk free interest rate of 1.65 percent. The amounts computed according to the Black-Scholes model method may not be indicative of the actual values realized upon the exercise of these options by the holders.

During the three and six-month periods ended June 30, 2019, the Corporation recognized total compensation expense of \$0.2 million and \$0.4 million, respectively (2018 - \$0.4 million and \$0.9 million) for share options granted between 2016 and 2019.

A summary of the status of the plan as at June 30, is presented below:

	2019		2018	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding, beginning of period	5,291,101	\$ 3.89	5,499,468	\$ 4.41
Granted	250,000	2.81	250,000	1.99
Exercised	(45,000)	1.95	-	-
Forfeited / cancelled	-	-	(41,667)	3.06
Expired	(200,000)	15.81	(1,667)	9.14
Outstanding, end of period	5,296,101	3.41	5,706,134	4.31
Options exercisable, end of period	4,056,091	3.51	3,254,454	5.42

The range of exercise prices for options outstanding at June 30, are as follows:

Options Outstanding					Options Exercisable	
Original Exercise Price	Number	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price		Number	Weighted-Average Exercise Price
\$ 1.55	1,318,334	1.68 yrs	\$ 1.55		1,318,334	\$ 1.55
1.71	175,000	3.13 yrs	1.71		116,666	1.71
1.79	575,000	3.13 yrs	1.79		383,331	1.79
1.95	165,267	2.29 yrs	1.95		131,933	1.95
2.00	200,000	3.69 yrs	2.00		66,664	2.00
2.81	200,000	4.69 yrs	2.81		-	2.81
2.83	50,000	4.69 yrs	2.83		-	2.83
3.41	25,000	2.40 yrs	3.41		25,000	3.41
4.06	1,305,000	2.68 yrs	4.06		869,997	4.06
4.15	415,000	2.68 yrs	4.15		276,666	4.15
6.87 - 15.81	867,500	0.64 yrs	7.07		867,500	7.07
	5,296,101	2.28 yrs	\$ 3.41		4,056,091	\$ 3.51

c) Retention Award Plan

The retention award plan results in eligible participants receiving cash compensation in relation to the value of a specified number of underlying notional retention awards. The retention award plan has two types of awards Restricted Awards (RAs) and Performance Awards (PAs). RAs vest evenly over a period of three-years. Upon vesting and subsequent exercise, the holder is entitled to receive a cash payment based on the fair value of the underlying

shares determined using the five-day weighted-average trading price of the shares ending immediately prior to the exercise date plus accrued re-invested dividends.

PAs vesting and subsequent exercise is similar to RAs, except a payout multiplier is applied to the final payout. The payout multiplier is linked solely to total shareholder return on the Corporation's common shares relative to returns on securities of members of the Corporation's peer comparison group over the applicable vesting period and can range from a payout of zero percent to 200 percent. For the six-month period ended June 30, 2019, 750,000 PAs were granted (2018 – 750,000), 566,668 PAs settled at a weighted-average payout multiplier of 192 percent (2018 – 66,664), no PAs were forfeited (2018 - nil), and, as at June 30, 2019, 1,316,668 PAs were outstanding (2018 – 883,336).

The Corporation recorded a total of \$4.0 million compensation expense relating to these plans for the six-month period ended June 30, 2019 (2018 - \$1.2 million). The expense is included in selling, general and administrative expense and has a corresponding liability included in trade and other payables. There were 3,596,709 RAs and PAs outstanding as at June 30, 2019 (2018 – 3,400,365).

A summary of the status of the plan as at June 30, is presented below:

	2019	2018
RAs and PAs outstanding, beginning of year	3,443,456	2,103,040
Granted	1,415,113	2,123,114
Settled	(1,231,191)	(702,247)
Forfeited / cancelled	(30,669)	(123,542)
RAs and PAs outstanding, end of year	3,596,709	3,400,365

d) Normal Course Issuer Bid

During the third quarter of 2018, the Toronto Stock Exchange ("TSX") approved the renewal of PHX Energy's Normal Course Issuer Bid ("NCIB") to purchase for cancellation, from time-to-time, up to a maximum of 2,915,311 common shares, representing 5 percent of the outstanding common shares at the time the NCIB was renewed. The NCIB commenced on August 8, 2018 and will terminate on August 7, 2019. Purchases of common shares are to be made on the open market through the facilities of the TSX and through alternative trading systems. The price which PHX Energy is to pay for any common shares purchased is to be at the prevailing market price on the TSX or alternate trading systems at the time of such purchase.

Pursuant to the NCIB, 357,500 common shares were purchased by the Corporation in the second half of 2018 and cancelled. For the six-month period ended June 30, 2019, the Corporation has purchased and cancelled 1,625,000

common shares. In total, pursuant to the NCIB 1,982,500 common shares have been purchased and cancelled by the Corporation as at June 30, 2019

The Corporation's previous NCIB commenced on June 26, 2017 and terminated on June 25, 2018. Pursuant to the prior NCIB, 125,000 common shares were purchased by the Corporation in the first six-months of 2018 and cancelled.

9. Other Income

(Stated in thousands of dollars)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2019	2018	2019	2018
Net gain on disposition of drilling equipment	(1,596)	(3,073)	(2,876)	(3,851)
Foreign exchange losses (gains)	246	(88)	512	(217)
Provision for (Recovery of) bad debts	280	-	326	(8)
Other expenses (income)	(1,070)	(3,161)	(2,038)	(4,076)

10. Fair Values of Financial Instruments

The Corporation has designated its trade and other payables as other financial liabilities carried at amortized cost. Trade and other receivables are designated as loans and receivables, measured at amortized cost. The Corporation's carrying values of these items approximate their fair value due to the relatively short periods to maturity of the instruments. Loans and borrowings have been designated as other financial liability, and are measured at amortized cost. The fair value of loans and borrowings included in the condensed consolidated statement of financial position approximates fair values as the indebtedness is subject to floating rates of interest.

Corporate Information

Board of Directors

John Hooks
Randolph ("Randy") M. Charron
Myron Tétreault
Judith Athaide
Lawrence Hibbard
Roger Thomas
Terry Freeman

Officers

John Hooks
CEO

Michael Buker
President

Cameron Ritchie
Sr. Vice President Finance and CFO
Corporate Secretary

Craig Brown
Sr. Vice President International Operations
and Technology

Jeffery Shafer
Sr. Vice President Sales and Marketing

Daniel Blanchard
Vice President Executive Sales

Legal Counsel

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

Auditors

KPMG LLP
Calgary, Alberta

Bankers

HSBC Bank Canada
Calgary, Alberta

Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta